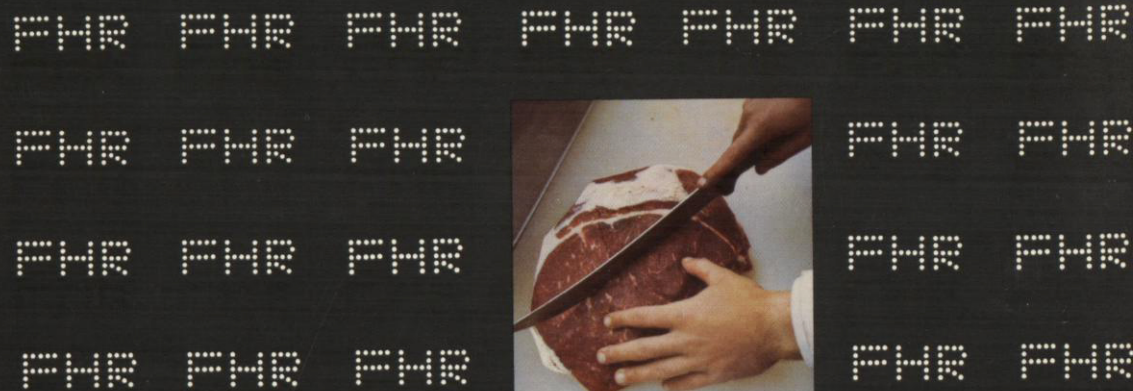


Fisher Foods, Inc. 1978 Annual Report

Fisher Foods, Inc.



Dominick's Supermarkets



Fazio's Supermarkets



Fisher's Food Warehouse Stores

Fisher Foods (NYSE—FHR) is a regional food retailing chain with volume approaching \$1.5 billion. The Company's principal stores are large supermarkets—presently 158 of them—located mainly in the suburbs of their metropolitan markets. These stores are notable for their range of specialized departments, such as in-store bakeries, delicatessens, and wine, cheese and flower shops. Fisher's sells numerous items of its own manufacture, including some in the Company's "Heritage House" line, one of the strong private labels in the industry.

Operations are organized into four divisions:

Dominick's Finer Foods—a chain of 68 supermarkets located throughout Greater Chicago, supported by warehouse/distribution centers, a frozen food commissary, a dairy and delicatessen kitchens. Dominick's also operates a number of limited-item \$ave-it stores in Chicago.

Fazio's—a chain of 79 supermarkets divided between the Northern Ohio and Southern Ohio Divisions. Support facilities include a mid-state depot, the Northern Ohio warehouse, baking and pizza companies, and an ice cream plant.

Warehouse Store Division—a new division presently operating 11 full-line, "no-frills" warehouse stores in the northern and southern areas of Ohio.

Highlights

	1978	1977
Net sales	\$1,451,676,000	\$1,536,523,000
Net income	9,829,000	4,384,000
Per Common Share	1.56	.68
Working capital	51,006,000	41,808,000
Common shareholders' equity . .	87,322,000	81,309,000
Per share	14.04	13.07
Dividends per Common Share . .	.60	.60
Number of Common Shares outstanding	6,221,341	6,221,341
Number of supermarkets	158	201

To Our Shareholders

CLEVELAND PUBLIC LIBRARY
BUSINESS INFO. BUREAU
CORPORATION FILE

The strong recovery in earnings, the consolidation of operations following the California sale, and the exciting new store programs under way mark 1978 as a significant year. What was accomplished in 1978 and the initiative and effort behind those results greatly enhance the prospects for 1979 and for growth over the longer term.

Earnings were \$1.56 per share, compared with \$.68 per share in 1977 when price wars cut heavily into margins. While the return to more normal pricing was a welcome advantage, price competition continues strong. There are other factors in the recovery that will have more influence on our profitability in 1979 and the 1980's.

Consolidation of Operations

Of major importance is the consolidation of operations into two main markets—Ohio and Greater Chicago. Fisher's California operations were sold on favorable terms in July. The sale provided \$.29 per share of 1978 earnings, strengthened the balance sheet, and made experienced executive talent available for reassignment. The consolidation, in turn, stepped up progress on existing programs and facilitated new programs to build sales.

Thus, during the second half of 1978, all divisions gained management depth and additional funds to expand. More new outlets, upgrading of stores, new marketing concepts, and innovative customer services were in place or under way.

A new president was named in Southern Ohio and Dominick's welcomed back a top manager who had served as president of the California Division for eight months.

The new Warehouse Store Division opened 10 warehouse stores on the same day in January after they were converted from conventional supermarkets in a three-day period. The new warehouse stores are supplied in part from a 150,000-square-foot central depot in Columbus which became operational in early March. Conversion and start-up costs of the warehouse store program will be reflected in first-quarter results.

Expansion, New Services

Dominick's added warehouse space near its Northlake headquarters to supply newly opened supermarkets and limited-item "Save-it" stores. Dominick's also expanded to four the supermarkets with price scanning.

The first price scanning installations in the northern Ohio area were introduced by Fazio's in January. These units are linked with Dominick's as one phase in establishing computer compatibility among all divisions.

SuperBanking in the Greater Cleveland market has progressed from computer terminal service in all stores to the first in a series of staffed mini-banks providing full banking services.

An extensive remodeling program has been launched to assure superior appearance and layout in all Ohio stores. Seven new supermarkets opened in 1978, in addition to two Save-it stores in Chicago; 10 to 12 new supermarkets are planned this year.

The purchase of a few stores that had been leased and a \$6,961,000 reduction in debt were other improvements in Fisher's balance sheet made possible by the California sale and increased cash flow.



John Fazio and Carl Fazio

All facets of the programs we've briefly described relate to customers' interests. Customers are the reason for everything Fisher's has been doing in maintaining quality standards, adding valued services and convenience, and combating the rising cost of food.

The future is bright, judging from the positive response to our warehouse stores, the other new programs in Ohio, and the very encouraging results from Dominick's new stores and programs. This reaction is indicative of Fisher's ability to anticipate customer needs and to respond with appealing, useful programs.

For their contributions and continued support in this effort, we want to express our sincere appreciation to the Board of Directors, our loyal shareholders, and the talented and dedicated management personnel and employees throughout the Company.

Carl Fazio

Carl Fazio
Chairman of the Board

John Fazio

John Fazio
President and Chief
Executive Officer

March 16, 1979



Management's Analysis of the Summary of Operations

1978 Compared with 1977

Net Sales declined 5.5%; however, if sales of the operating divisions that were sold during the reporting periods (California, 1978 — \$159,667,000, 1977 — \$288,956,000; Claber and Neighbor-X Drug Stores, 1978—\$0, 1977—\$16,086,000) were eliminated, the Company would have experienced a gain in sales of 4.9%.

Other Income was \$3,803,000 higher in 1978. The increase in cash and cash equivalents derived from the sale of the California Division and improved yields in the money markets resulted in an increase of \$1,200,000 in investment income. The 1977 losses incurred, related to California store closings, were not repeated in 1978 and the overall favorable difference on property disposals approximated a \$760,000 improvement in 1978. Two other favorable factors in 1978 were rental income, which rose by slightly over \$625,000, and the increase in 1978 by \$440,000 in the gain from purchase by the Company of its debentures.

Gain on Disposal of Operating Divisions of \$3,160,000 before tax occurred in 1978 when the Company sold the California Division consisting of 46 stores and support facilities.

Cost of Merchandise Sold, which is comprised of the cost of purchased and manufactured products, and the cost of warehousing and distribution, decreased in 1978 to 76.13% of sales from 76.76% of sales. This improvement in margin is a reflection of the 1977 price wars in both Ohio and California.

Selling, General and Administrative Expenses declined by

\$15,797,000 but remained nearly level when compared with sales. Selling, general and administrative expenses were 22.54% of sales in 1978 and 22.33% of sales in 1977. On a percent of sales basis, store payroll costs, rent and utilities rose while taxes, advertising and variable expenses fell.

Interest on Debt was \$599,000 lower in 1978, occasioned by the continuing reduction in total long-term debt and the absence of short-term bank borrowing.

Interest on Lease Obligations dropped in 1978 by \$90,000 with the sale of the California Division, the assumption by the purchaser of the related leases, and the expiration effect of present leases which more than offset the increase in lease obligations on new 1978 stores and the full-year effect of leases added during 1977.

The effective tax rose in 1978 to 38.5% from 8.9%; income before taxes increased substantially, and the investment tax credit declined to \$1,437,000 from \$1,606,000 in 1977.

1977 Compared with 1976

Net Sales increased 6.5%; inflation and new stores were major factors.

Other Income was \$1,145,000 less than in 1976. The major reasons were the discontinuance of the Kanco wholesaling operation (\$570,000), a reduction in short-term investment income (\$333,000), and an increased loss on the disposal of fixed assets, largely California store closings (\$269,000).

Gain on Disposal of Operating Division of \$1,618,000 before taxes resulted from the sale in

1977 of the Claber Division in Pittsburgh and the Neighbor-X Drug Store Division in Chicago.

Cost of Merchandise Sold remained very consistent, representing 76.76% of sales in 1977 and 76.71% of sales in 1976.

Selling, General and Administrative Expenses in 1977 exceeded 1976 expenses by \$38,414,000. Store labor and related fringe benefits were responsible for approximately two-thirds of the increase as contractual union wage escalations and government-mandated increases in benefit costs exceeded productivity gains. Increases in utility expenses of \$2,500,000, rent and lease related taxes of \$1,900,000, repair and maintenance of \$1,300,000 and advertising of \$1,000,000 accounted for a majority of the remainder.

Interest on Debt was lower in 1977 by \$210,000. An increase in average short-term bank borrowings was more than offset by a reduction in long-term debt and the full-year effect of the 1976 early repayment of a major term loan.

Interest on Lease Obligations increased \$318,000 in 1977 because of new lease obligations and because interest rates on new leases exceeded the interest rates on expiring leases.

The effective tax rate for 1977 was 8.9%, due mainly to the application of an investment tax credit of \$1,606,000 to the federal income tax provision, producing a substantial reduction from the statutory rate. In 1976, a more normal effective tax rate of 43.0% occurred as the investment tax credit of \$1,275,000 was applied against a much higher pre-tax income.

Five-Year Summary of Operations

	1978	1977	1976	1975	1974
Net sales	\$1,451,676,000	\$1,536,523,000	\$1,442,546,000	\$1,383,671,000	\$1,124,404,000
Cost of merchandise sold	1,105,216,000	1,179,406,000	1,106,555,000	1,082,399,000	878,715,000
Interest expense—debt	7,410,000	8,009,000	8,219,000	8,794,000	6,155,000
Interest on lease obligations	5,164,000	5,254,000	4,936,000	4,495,000	3,977,000
Income taxes	6,159,000	430,000	9,354,000	8,692,000	10,056,000
Net income	9,829,000	4,384,000	12,383,000	11,863,000	12,207,000
Net Income per Common Share:					
Primary	1.56	.68	1.97	1.89	1.96
Fully diluted	1.43	.68	1.76	1.71	1.81
Dividends per Common Share	.60	.60	.40	.40	.35
Working capital	51,006,000	41,808,000	40,991,000	45,022,000	29,464,000
Property, plant and equipment (net)	126,203,000	132,920,000	134,294,000	127,864,000	116,451,000
Leased property under capital leases (net)	41,152,000	48,036,000	41,614,000	39,380,000	35,003,000
Long-term debt	78,337,000	85,298,000	89,079,000	100,168,000	83,636,000
Obligations under capital leases	45,366,000	52,574,000	45,134,000	42,187,000	37,238,000
Common shareholders' equity	87,322,000	81,309,000	80,786,000	70,996,000	61,667,000
Common shareholders' equity per share	14.04	13.07	12.99	11.47	10.01
Average number of Common Shares outstanding	6,221,341	6,221,341	6,221,262	6,188,199	6,163,345

Dividends Paid

	1978	1977
First Quarter	\$.15	\$.15
Second Quarter	.15	.15
Third Quarter	.15	.15
Fourth Quarter	.15	.15
Total	\$.60	\$.60

Price Range of Common Shares (NYSE)

	1978		1977	
	High	Low	High	Low
First Quarter	\$ 8.250	\$7.375	\$13.125	\$11.000
Second Quarter	11.750	8.375	11.625	8.500
Third Quarter	12.750	9.250	9.875	8.375
Fourth Quarter	11.500	8.250	9.000	7.125

Review of Operations

Management Assignments Add Depth and Breadth

The sale last year to Albertson's of Fisher Foods California operations, besides strengthening the balance sheet, also freed a body of upper and mid-level managers for key positions in Chicago and Ohio. The three regional divisions and the Warehouse Store Division now have full complements in operating management.

In Chicago, Dominick DiMatteo, Jr. brought Joe Bagel back from California, where he had served as president of Fazio's during 1978, and named him president of Dominick's. Robert D'Amato, who has served in a variety of assignments for Dominick's, was elevated to the post of executive vice president. Dominick DiMatteo, Jr. became chairman of the subsidiary, Dominick's Finer Foods, and continues as chief executive officer.

Harry W. (Moe) Morter, in charge of marketing in California, was named president of the Southern Ohio Division, succeeding Milton Kantor.

Marshall J. Italiano, completing his first year as president of the Northern Ohio Division, has

bolstered his staff with experienced purchasing and operating managers with whom he worked in California. Among these is George Golleher, new controller for Northern and Southern Ohio. Executives joining the division from outside the Company include Donald Brennan as vice president for real estate and engineering.

The Warehouse Store Division is headed by Milton Kantor as president, a critical assignment in addition to his responsibility in corporate buying. Before rejoining the Company two years ago, he had opened the warehouse store that became the prototype for Fisher's program. The division's executive vice president is Dennis Bossi, previously director of management systems in Northern Ohio.

Warehouse Stores— Everybody Saves

Implementation of a substantial warehouse store retailing program followed promptly after the Warehouse Store Division was organized last fall. On January 17, ten warehouse stores opened simultaneously, an accomplishment without precedent in the industry. Counting the first store established earlier in Cincinnati, there are now seven warehouse stores in Southern Ohio and four in Northern Ohio.

All of the warehouse stores in the program were formerly supermarkets. A few have retained their delicatessen departments and in-store bakeries. As a group they are unique in having a full range of supermarket departments to meet all



of the customer's shopping needs from staples through fresh meats, produce, dairy, wine, cheese and flowers. Apart from this and the supermarket standard of quality, the stores are strictly "no frills" operations. Customers choose, mark and pack their own purchases. Fisher's passes on its savings from reduced handling and service costs. This cooperative effort can cut food bills significantly.

Portions of the inventories for the warehouse stores will be shipped from a newly leased central depot. The warehousing center in Columbus will also serve as a breakdown point for deliveries to supermarkets across Southern Ohio and as the receiving/shipping center for all health and beauty products for Chicago and Ohio.

Checkout Scanning Progress

Computerized price scanning at the checkout counter is another area providing better customer service, operating efficiency and economy. Wherever scanning has been introduced, public acceptance has been favorable. Checkout lines move faster, each customer receives a fully itemized and highly accurate register tape, and the store's internal controls improve.

Dominick's has expanded its computerized scanning and now has four stores in the program. Northern Ohio has made similar installations in two of its largest stores. The introduction was supported by a thorough orientation program for customers. Following this step, Fisher's entire computer network is being revamped to provide hardware and software compatibility among the Ohio and Chicago stores and all service/administrative outlets. This will result in

faster, more accurate information for decision making and improved customer service.

Expansion in Manufacturing

Fisher's manufacturing operations are a growing source of volume and profit. Products from these subsidiaries are supplied to Fisher's stores without the middleman's markup; sales to other accounts provide additional income. Manufacturing control over a number of the products in Fisher's private label program has helped make "Heritage House" one of the strong house brands in the industry.

During the year, Fisher's extended the sale of its ice cream throughout Ohio and Chicago, and all divisions started selling pizza from a newly acquired subsidiary.

Banking Services

SuperBanking, a comprehensive new service with Society National Bank of Cleveland, began last fall. The program includes the use of Master Charge, eliminates in-store check cashing, and is proving an attraction as well as a convenience. From its first appearance in a selected





group of stores, SuperBanking was rapidly expanded to provide terminals for basic banking transactions in all the Greater Cleveland stores. The first mini-bank in the program, staffed by Society personnel, opened in a suburban store in February. The goal is to provide banking services in all Fazio supermarkets in Ohio.

New Stores Opened, Many Others To Be Remodeled

During 1978 Fisher Foods opened seven supermarkets in Greater Chicago and Ohio. All exceed 33,000 square feet. Each has a full range of specialized departments, such as in-store bakery, delicatessen, fresh fish, and wine and cheese. These openings continue the program begun three years ago under which fewer but larger stores are built each year and paid for from cash flow.

Dominick's also opened two "\$ave-it" stores in the Chicago area during the past six months. These are limited-item stores that do not sell perishables. They serve as a basis for thoroughly testing methods and market response before a greater commitment is made.

With the closing of three smaller supermarkets last year, Fisher Foods now operates 158 supermarkets in Ohio and Chicago. Of the 90 supermarkets in Ohio, over a quarter are less than five years old. All the older stores are undergoing a thorough appraisal of their condition preliminary to a broad-scale remodeling program. As in Ohio, Dominick's continues to open supermarkets and to upgrade its stores in the growing suburbs of Chicago.

Management and employees at all levels are committed to serving customers "one at a time," a working slogan that is stimulating the constant effort to provide the atmosphere, service, quality products, and prices that win more customers and earn more profit.





Statement of Consolidated Income and Retained Earnings

Fisher Foods, Inc. and Subsidiaries

	Fiscal Year Ended	
	December 30, 1978	December 31, 1977
Net sales	\$1,451,676,000	\$1,536,523,000
Other income—net	6,222,000	2,419,000
Gain on disposal of operating divisions—Note J	3,160,000	1,618,000
	<u>1,461,058,000</u>	<u>1,540,560,000</u>
Costs and expenses:		
Cost of merchandise sold	1,105,216,000	1,179,406,000
Selling, general and administrative	327,280,000	343,077,000
Interest on debt	7,410,000	8,009,000
Interest on lease obligations	5,164,000	5,254,000
	<u>1,445,070,000</u>	<u>1,535,746,000</u>
Income Before Income Taxes	15,988,000	4,814,000
Income taxes—Notes A and H	6,159,000	430,000
Net Income	9,829,000	4,384,000
Retained earnings—beginning of year	60,007,000	59,484,000
Cash dividends:		
\$.60 a share on Common Shares,		
\$5 a share on Preferred Stock	(3,858,000)	(3,861,000)
Preferred Stock—943 shares		
purchased and retired	42,000	—0—
Retained earnings—end of year	<u>\$ 66,020,000</u>	<u>\$ 60,007,000</u>
Net income per Common Share—Note A:		
Primary	\$1.56	\$.68
Fully diluted	1.43	.68

See notes to consolidated financial statements.

Consolidated Balance Sheet

Fisher Foods, Inc. and Subsidiaries

ASSETS	December 30, 1978	December 31, 1977
Current Assets		
Cash and cash equivalents—Note B	\$ 40,221,000	\$ 23,293,000
Accounts receivable	12,128,000	12,475,000
Inventories—Note A	100,153,000	110,480,000
Prepaid expenses	6,508,000	7,134,000
Total Current Assets	159,010,000	153,382,000
Investments and Other Assets		
Investments	5,471,000	5,586,000
Other assets	2,854,000	4,870,000
	8,325,000	10,456,000
Property, Plant and Equipment— on the basis of cost—Notes A and D		
Land	9,967,000	9,240,000
Buildings	37,243,000	36,373,000
Fixtures and equipment—Note E	146,490,000	139,546,000
Leasehold improvements	15,728,000	23,506,000
	209,428,000	208,665,000
Less allowances for depreciation and amortization	83,225,000	75,745,000
	126,203,000	132,920,000
Leased Property Under Capital Leases— net of amortization—Notes A and F	41,152,000	48,036,000
	\$334,690,000	\$344,794,000

LIABILITIES AND SHAREHOLDERS' EQUITY

	December 30, 1978	December 31, 1977
Current Liabilities		
Trade accounts payable	\$ 73,355,000	\$ 79,627,000
Accrued expenses	18,135,000	19,577,000
State and local taxes	5,717,000	6,469,000
Income taxes—Notes A and H	5,184,000	—0—
Current portion of long-term debt	3,650,000	3,330,000
Current portion of obligations under capital leases	1,963,000	2,571,000
Total Current Liabilities	108,004,000	111,574,000
Long-Term Debt—Note D	78,337,000	85,298,000
Obligations Under Capital Leases—Note F	45,366,000	52,574,000
Deferred Income Taxes—Note H	9,732,000	7,878,000
Reserve for Employees' Retirement—Notes A and I	3,453,000	3,591,000
Shareholders' Equity		
Capital stock—Note G:		
Preferred Stock	2,476,000	2,570,000
Common Shares	21,302,000	21,302,000
Retained earnings—Note D	66,020,000	60,007,000
	89,798,000	83,879,000
Commitments—Note F		
	\$334,690,000	\$344,794,000

See notes to consolidated financial statements.

Statement of Consolidated Changes in Financial Position

Fisher Foods, Inc. and Subsidiaries

	Fiscal Year Ended	
	December 30, 1978	December 31, 1977
Source of Funds		
Net income	\$ 9,829,000	\$ 4,384,000
Add expenses not requiring working capital in the current period:		
Depreciation and amortization of property, plant and equipment—Note A	15,918,000	15,655,000
Amortization of capital leases	3,419,000	3,656,000
Noncurrent deferred taxes	1,854,000	1,780,000
Total from Operations	31,020,000	25,475,000
Additions to long-term debt	4,422,000	—0—
Additions to obligations under capital leases	8,104,000	10,078,000
Property disposals—net	1,190,000	3,270,000
Disposal of operating divisions—Note J	10,623,000	1,059,000
	<u><u>\$55,359,000</u></u>	<u><u>\$39,882,000</u></u>
Use of Funds		
Payments on long-term debt	\$ 6,002,000	\$ 3,781,000
Payments on obligations under capital leases	2,297,000	2,638,000
Expenditures for property, plant and equipment	24,654,000	18,610,000
Capitalization of leased property under capital leases	8,104,000	10,078,000
Cash dividends	3,858,000	3,861,000
Other—net	1,246,000	97,000
Increase in working capital	9,198,000	817,000
	<u><u>\$55,359,000</u></u>	<u><u>\$39,882,000</u></u>
Increase (Decrease) in Working Capital		
Cash and cash equivalents	\$16,928,000	\$ (1,380,000)
Accounts receivable	(347,000)	3,113,000
Inventories	(10,327,000)	(1,618,000)
Prepaid expenses	(626,000)	1,854,000
Trade accounts payable	6,272,000	(5,740,000)
Accrued expenses	1,442,000	(2,159,000)
State and local taxes	752,000	194,000
Income taxes	(5,184,000)	5,898,000
Current portion of long-term debt	(320,000)	522,000
Current portion of obligations under capital leases	608,000	133,000
Increase in Working Capital	<u><u>\$ 9,198,000</u></u>	<u><u>\$ 817,000</u></u>

See notes to consolidated financial statements.



Notes to Consolidated Financial Statements

Fisher Foods, Inc. and Subsidiaries

Fiscal years ended December 30, 1978 and December 31, 1977

Note A—Summary of Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION: The consolidated financial statements include the accounts of the Company and its subsidiaries. All material intercompany accounts and transactions have been eliminated.

INVENTORIES: Inventories are stated at the lower of cost (first-in, first-out) or market, including store inventories that are calculated by the retail method.

LEASED PROPERTY UNDER CAPITAL LEASES: Capital leases are recorded at the lower of fair value of the leased property or the present value of the minimum lease payments at the inception of the lease. Amortization of leased property is computed by the straight-line method over the term of the lease.

DEPRECIATION: Depreciation and amortization of property, plant and equipment is computed by the straight-line method over the estimated useful lives of the assets for financial reporting purposes. Accelerated depreciation methods are used for income tax purposes.

PRE-OPENING COSTS: Store pre-opening costs are charged to expense as incurred.

INCOME TAXES: The investment tax credit is applied as a reduction of the provision for income taxes in the year the related property is placed in service.

PENSION AND RETIREMENT PLANS: The Company provides for retirement benefits for substantially all of its employees through a Company pension plan, a subsidiary's profit-sharing plan, and various union-administered retirement plans. The reserve for employees' retirement benefits established in prior years for the Company pension plan is being amortized over 30 years for the funding of past service liability. Pension costs under the Company plan include normal costs and interest on and additional amortization of unfunded past service cost. Retirement costs under the subsidiary's profit-sharing plan and the union-administered plans are based on stipulated rates.

NET INCOME PER COMMON SHARE: Primary net income per Common Share is computed by dividing net income less preferred stock dividends by the average number of Common Shares outstanding during the period.

Fully diluted net income per Common Share is computed as above and also assumes conversion, if dilutive, of the Convertible and Exchangeable Subordinated Debentures into Common Shares and elimination of related interest expense, net of income taxes, as well as the assumed issuance of additional Common Shares under outstanding stock option plans using the "treasury stock" method if dilutive.

BUSINESS SEGMENTS: Substantially all of the Company's assets, revenue and operating income are employed in or derived by the retail food business in the United States.

Note B—Cash and Cash Equivalents

At the end of 1978, cash and cash equivalents includes \$15,872,000, of negotiable certificates of deposit and commercial paper, valued at cost which approximates market.

Note C—Short-Term Borrowings

Under the terms of the Company's 9½% senior promissory notes, the Company is permitted a maximum of \$15,000,000 of short-term debt. The Company has lines of credit arrangements with various banks; two of these arrangements require the maintenance of compensating balances. These compensating balances were immaterial during 1978 and 1977 and at each year-end.

There were no short-term borrowings during 1978. Short-term debt was not present at year-end in 1977; however, during 1977 the highest short-term borrowings at any month-end was \$6,000,000. The daily average borrowings (total of daily outstanding principal divided by 364) was \$3,003,000. The weighted average interest rate (actual expense divided by average short-term debt outstanding) on this debt was 6.64%.

Notes continued

Note D—Long-Term Debt

	1978	1977
9½% Senior promissory notes to insurance companies— \$2,700,000 due annually December 15 through 1986	\$21,600,000	\$24,300,000
9½% Senior promissory notes to insurance companies— \$1,500,000 due annually commencing July 15, 1980	15,000,000	15,000,000
Real estate mortgages, equipment purchase notes, and unsecured notes to banks and others, payable in varying amounts to 1991 at interest rates ranging from 4.0% to 10.0%	15,120,000	16,786,000
6½% Convertible Subordinated Debentures—\$900,000 due annually commencing June 1, 1979	15,267,000	17,542,000
8¾% Exchangeable Subordinated Debentures—due June 15, 1984	15,000,000	15,000,000
	81,987,000	88,628,000
Less amounts due within one year included in current liabilities	3,650,000	3,330,000
TOTALS	<u>\$78,337,000</u>	<u>\$85,298,000</u>

The average rate of interest on the Company's long-term debt was 8.46% at December 30, 1978.

At December 30, 1978, certain property, plant and equipment with an aggregate net book value of \$19,238,000 was pledged to secure real estate mortgage notes and equipment purchase notes.

The 6½% Convertible Subordinated Debentures due June 1, 1994, are convertible into Common Shares of the Company at \$26.81 per share, subject to antidilution provisions, and accordingly 569,452 Common Shares have been reserved for future conversion. The debentures may be redeemed at the Company's option at 103.6% of par through June 1, 1979, and at decreasing percentages of par thereafter. The Company has purchased \$2,733,000 (1978—\$2,275,000, 1977—\$458,000) of the debentures in anticipation of the annual sinking fund requirements of \$900,000 annually commencing June 1, 1979. The Company has sufficient debentures in treasury to satisfy sinking fund requirements through 1981.

The 8¾% Exchangeable Subordinated Debentures due June 15, 1984, are exchangeable into Common Shares of the Company at \$20.00 per share, subject to antidilution provisions, and accordingly 750,000 shares have been reserved for conversion.

Terms of the promissory note agreement (as amended in 1978), the Convertible Subordinated Debenture Indenture, and the Exchangeable Subordinated Debentures include, in addition to others, covenants relative to payments for acquisition of capital stock of the Company and of dividends other than stock dividends. Approximately \$15,000,000 of retained earnings were available for such payments at December 30, 1978.

Note E—Fixtures and Equipment Leased

In connection with the sale of the California Division (see Note J), certain fixtures and equipment are leased under various operating leases. These assets have a cost of \$25,577,000 with accumulated depreciation of \$9,458,000 at December 30, 1978. Minimum future rentals receivable under these operating leases are as follows:

Fiscal Year	
1979	\$ 3,949,000
1980	3,949,000
1981	3,949,000
1982	2,763,000
1983	1,576,000
Later years	1,658,000
	<u>\$17,844,000</u>

Note F—Leases

Most of the Company's retail stores are leased under capital leases. In addition, some of the store-related equipment is leased under capital leases. Many leases contain contingent rentals which are based on a particular store achieving a certain volume. The Company has the option to extend the term of the lease in the majority of lease contracts.

Capital Leases:

Leased property under capital leases consists of the following amounts for leases that have been capitalized:

	1978	1977
Land and buildings	\$58,085,000	\$66,266,000
Fixtures and equipment	2,037,000	2,499,000
	<u>60,122,000</u>	<u>68,765,000</u>
Less allowances for amortization	18,970,000	20,729,000
	<u>\$41,152,000</u>	<u>\$48,036,000</u>

The following is a schedule by years of future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 30, 1978.

Fiscal Year	
1979	\$ 7,723,000
1980	7,530,000
1981	7,254,000
1982	7,049,000
1983	6,844,000
Later years	<u>77,568,000</u>
Total minimum lease payments	113,968,000
Less amounts representing executory costs (such as taxes, maintenance and insurance) included in total minimum lease payments	<u>13,657,000</u>
Net minimum lease payments	100,311,000
Less imputed interest	<u>52,982,000</u>
Present value of net minimum lease payments	47,329,000
Less amount due within one year included in current liabilities	<u>1,963,000</u>
Obligations under capital leases	<u>\$ 45,366,000</u>

Operating leases:

Minimum rentals under noncancellable operating leases at December 30, 1978 for the indicated years are as follows:

Fiscal Year	
1979	\$ 5,545,000
1980	5,462,000
1981	4,660,000
1982	4,526,000
1983	4,388,000
Later years	<u>48,348,000</u>
Total minimum payments	<u>\$72,929,000</u>

Total rental expense for all operating leases was as follows:

	1978	1977
Minimum rental	\$ 6,200,000	\$ 7,116,000
Contingent rental	711,000	771,000
Sublease rental income	(75,000)	(48,000)
	<u>\$ 6,836,000</u>	<u>\$ 7,839,000</u>

Note G—Capital Stock

	Number of Shares December 30, 1978		
	Authorized	Outstanding*	Reserved
Preferred Stock—\$5 cumulative, nonvoting, without par value; redeemable at \$105 a share, stated at the involuntary liquidation price—outstanding as of December 31, 1977—25,700	27,000	24,757	—0—
Serial Preferred Stock—no change in either year	500,000	—0—	—0—
Common Shares—without par value—no change in either year	15,000,000	6,221,341	1,423,977

*Outstanding shares are after deducting 7,323 Common Shares in treasury.

Under the Company's stock option plan, the Company granted options to officers and other key employees to purchase Common Shares at not less than fair market value at date of grant. Options become exercisable after one year from date of grant in varying proportions and expire five years

Note K—Pending Legal Proceedings

The Company is involved in a number of legal proceedings incidental to its business. Management believes that the liability, if any, resulting from such proceedings in the aggregate will not have a material adverse effect on the consolidated financial position.

Note L—Summary of Quarterly Results of Operations (Unaudited)

The following is a summary of unaudited quarterly results of operations for the fiscal years ended December 30, 1978 and December 31, 1977 (000 omitted, except for per share data):

	Quarter Ended			
	March 25, 1978	June 17, 1978	October 7, 1978	December 30, 1978
Net sales	\$362,890	\$371,611	\$406,254	\$310,921
Gross profit	88,247	91,117	95,824	71,117
Net income	1,647	2,520	3,570	2,092
Net income per Common Share:				
Primary	.26	.40	.57	.33
Fully diluted	.25	.36	.51	.31

	Quarter Ended			
	March 26, 1977	June 18, 1977	October 8, 1977	December 31, 1977
Net sales	\$351,760	\$355,818	\$464,883	\$364,062
Gross profit	82,333	83,197	105,448	86,139
Net income	1,488	350	580	1,966
Net income per Common Share:				
Primary	.23	.05	.09	.31
Fully diluted	.23	.05	.09	.29

Income tax expense was reduced approximately \$450,000 in the fourth quarter of 1977 as a result of a reduction of the effective tax rate as compared to previous quarters.

Note M—Asset Replacement Cost (Unaudited)

The impact of inflation on the Company's inventory is insignificant because of the rapid turnover.

Replacing items of building, fixtures, and equipment with assets having equivalent marketing capacity has usually required a substantially greater capital commitment than was required to acquire the assets that are being replaced. The additional capital commitment principally reflects the cumulative impact of inflation on the long-lived nature (approximately 10 years for fixtures and equipment and 25 years for buildings) of these assets.

The Company's annual report on Form 10-K contains specific information with respect to the 1978 and 1977 replacement cost of inventories and marketing capacity (generally buildings, equipment, and fixtures), and the approximate effect that replacement cost would have had on the computation of cost of sales and depreciation expense for those years.

Notes continued

from date of grant. In 1977, the time period for awarding options expired; thus no additional options may be granted under this plan. Information as to shares under option follows:

	Shares	Option Price Per Share
Outstanding at January 1, 1977	170,371	10.00 to 19.59
Granted	81,875	10.25 to 12.88
Cancelled	62,104	10.00 to 19.59
Outstanding at December 31, 1977	190,142	10.00 to 15.26
Cancelled	85,617	10.00 to 15.26
Outstanding at December 30, 1978	104,525	10.00 to 14.875
Exercisable	60,394	10.00 to 14.875

Note H—Income Taxes

Income taxes consist of the following:

	1978		1977	
	Current	Deferred	Current	Deferred
Federal	\$4,184,000	\$1,277,000	\$ (765,000)	\$ 625,000
State and local	702,000	(4,000)	683,000	(113,000)
TOTALS	<u>\$4,886,000</u>	<u>\$1,273,000</u>	<u>\$ (82,000)</u>	<u>\$ 512,000</u>

Deferred income taxes result principally from timing differences in reporting depreciation expense, lease obligations, and certain liabilities for financial statements and taxes.

The reasons for the differences between total income tax expense and the amount computed by applying the statutory federal income tax rate of 48% to income before taxes are as follows:

	1978	1977
48% of pre-tax income	\$7,674,000	\$2,311,000
State and local taxes net of federal tax benefits	363,000	296,000
Investment tax credit	(1,437,000)	(1,606,000)
Capital gains on disposal of operating divisions	(377,000)	(228,000)
Other items	(64,000)	(343,000)
TOTALS	<u>\$6,159,000</u>	<u>\$ 430,000</u>

Note I—Pension Plan

Total pension and retirement costs amounted to \$11,126,000 (1977—\$11,095,000).

For the Company's plan, fund assets and balance sheet accruals as of the latest valuation date exceeded vested benefits. The unfunded past service liability approximated \$2,600,000 at the latest valuation date. The Company's policy is to fund the minimum amount required by the Employee Retirement Income Security Act of 1974; however, at the end of 1978 the Company had prefunded \$1,569,000 (1977—\$1,052,000) of required future pension contributions.

Note J—Sale of Operating Divisions

During the third quarter of 1978, the Company sold its California Division consisting of 46 stores and support facilities. The sale resulted in a gain of \$1,813,000 (\$.29 a share) after income taxes of \$1,347,000. The following summarizes the non-current net assets sold:

Property, plant and equipment	\$14,263,000
Leased property under capital leases	10,587,000
Other assets	2,843,000
Obligations under capital leases	(11,689,000)
Long-term debt	(5,381,000)
Non-current assets—net	<u>\$10,623,000</u>

During the third quarter of 1977, the Company sold its Claber Division consisting of eight small discount stores in Pittsburgh and the Neighbor-X Drug Store Division in Chicago. These sales produced gains of \$934,000 (\$.15 a share) after income taxes of \$684,000.

Report of Independent Auditors

Shareholders and Board of Directors
Fisher Foods, Inc.
Cleveland, Ohio

We have examined the consolidated balance sheet of Fisher Foods, Inc. and subsidiaries as of December 30, 1978 and December 31, 1977, and the related statements of consolidated income and retained earnings and changes in financial position for the fiscal years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of Fisher Foods, Inc. and subsidiaries at December 30, 1978 and December 31, 1977, and the consolidated results of their operations and changes in their financial position for the fiscal years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Ernst & Ernst

E&E

Cleveland, Ohio
February 15, 1979

Directors and Officers



Carl Fazio, John Fazio and Dominick DiMatteo, Jr.



Carl Fazio, Jr., David F. Leahy and Marshall J. Italiano



Charles W. Fazio and Wendell Earle



George J. Grabner, John L. Dampeer and Robert G. Everett

Directors:

John L. Dampeer*
Partner, Thompson, Hine and Flory

Dominick DiMatteo, Jr.*

Wendell Earle
Professor of Marketing,
N.Y.S. College of Agriculture,
Cornell University

Robert G. Everett*

Carl Fazio*

Carl Fazio, Jr.
Executive Vice President,
Heritage House Products Corporation

Charles W. Fazio
President,
F.F. and O. International
Enterprises, Inc.

John Fazio*

George J. Grabner
President, The Lamson &
Sessions Co.

Marshall J. Italiano*

David F. Leahy
Formerly Regional Manager,
Sears, Roebuck & Company,
now retired.

Charles E. Spahr
Professional Director. Formerly
Chairman of the Board, The
Standard Oil Company (Ohio),
now retired.

**An officer of Fisher Foods, Inc.*

Officers:

Carl Fazio
Chairman of the Board

John Fazio
President and Chief
Executive Officer

Dominick DiMatteo, Jr.
Senior Vice President

Robert G. Everett
Executive Vice President—
Finance and Administration

Marshall J. Italiano
Vice President

Joseph Bagel
Vice President

John L. Dampeer
Secretary

William T. Flyg
Controller

Corporate Headquarters:

Fisher Foods, Inc.
5300 Richmond Road
Bedford Heights, Ohio 44146
Telephone (216) 292-7000

Registrar & Transfer Agent

Common Shares and
Preferred Stock:
National City Bank
623 Euclid Avenue
Cleveland, Ohio 44114

Trustee

6½% Convertible
Subordinated Debentures:
Citibank, N.A.
111 Wall Street, New York,
N.Y. 10015

Auditors

Ernst & Ernst
Cleveland, Ohio

Counsel

Thompson, Hine and Flory
Cleveland, Ohio

New York Stock Exchange
Ticker Symbol: FHR

Annual Meeting

The annual meeting of
shareholders will be held on
Tuesday, April 17, 1979, at
10:00 A.M. Cleveland time,
at the Bond Court Hotel,
East Sixth Street and St. Clair
Avenue, Cleveland, Ohio.

Form 10-K Annual Report

Any shareholder, upon
written request addressed
to the Controller of the
Company, may obtain a
copy of the latest Form 10-K
Annual Report filed by the
Company with the
Securities and Exchange
Commission.



5300 Richmond Road
Bedford Heights
Ohio 44146